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SUBJECT: KAZAKHSTAN - KMG EXPRESSES OPTIMISM ON CPC EXPANSION

**¶1.** (SBU) KazMunaiGas (KMG) head Kairgeldy Kabyldin told the Ambassador on September 2 that progress was being made in negotiations over the expansion of the CPC pipeline. Transneft CEO Nikolay Tokarev was in Astana, along with ExxonMobil and Chevron executives, to continue discussions on the issue. Kabyldin said that all of the consortium members have reached agreement in principle to expand capacity from 690,000 barrels per day to 1.3 million barrel per day by 2015. (Note: Energy Minister Mynbayev echoed these comments on September 4, in remarks he made to KazEnergy Forum in Astana, explaining that only "technical details" still needed to be worked out. End Note.) The negotiations, Kabyldin maintained, had been complicated by expected changes to the equity structure of the CPC consortium: the purchase of Oman's 7 percent stake will result in Transneft's share increasing to 27.1 percent and KMG's to 22.9 percent -- i.e., a 50 percent overall stake for the two companies. Kabyldin expressed optimism that an agreement would be finalized in the very near future.

**¶2.** (SBU) Arman Darbayev, KMG Executive Director for Oil Transportation and long-time deputy to Kabyldin, told us on September 3 that KMG drafted a Memorandum of Understanding (MOU) on CPC expansion in July and circulated it for review among the CPC consortium members. According to Darbayev, all but one of the companies had accepted the terms of the memorandum. LUKARCO, a joint venture of British Petroleum and Lukoil, has expressed reservations and is holding out until it is satisfied on several issues, including volume allocation and access rights; tariff increases tied to capital expenditure increases; financial penalties to guarantee oil flow quantities; and the refinancing of equity debt through third-party project finance vehicles. According to Darbayev, KMG and other CPC partners are exerting pressure on LUKARCO to sign the MOU as soon as possible. Darbayev expressed hope that the parties would reach consensus on these issues by the end of September, but he noted that time is running out. The current feasibility study for CPC expansion expires in October and if negotiations continued past that deadline, the parties would need to commission a new feasibility study, which could delay negotiations still further.

**¶3.** (SBU) Jonathan Popper, British Petroleum's lead negotiator on CPC expansion, confirmed to the DCM on September 4 that LUKARCO is not satisfied with the current terms, but did not want to block CPC expansion entirely. He explained that LUKARCO is not a significant shareholder in Tengizchevroil (TCO) -- its stake is just 5 percent -- and thus does not need CPC expansion to accommodate LUKARCO's share of increased TCO production. Popper said that LUKARCO had met with Kabyldin on September 4 and offered to sell to KMG its share in CPC as a way to resolve the impasse. Popper said he told Kabyldin to "make us an offer so we can exit gracefully."

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